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Forbes, George Mather

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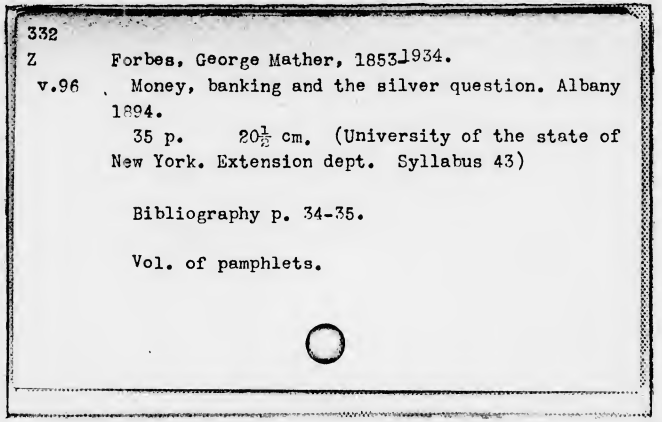

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332

MONEY, BANKING AND THE SILVER QUESTION

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References for each lecture are found in connection with the syllabus of that lecture. Concise, popular works are placed first, followed by more exhaustive and technical discussions, precedence being given in each division to those considered most helpful.

Three topics for papers are given with each lecture. Papers on the first require reproduction of some thought or argument of the lecture; on the second, reading for which references are given; on the third, reflection and application of principles discussed.

Lecture 1

ORIGIN, NATURE AND FUNCTIONS OF MONEY

Origin

1 Division of labor the basis of exchange.

2 Barter the primitive form of exchange.

3 Friction and difficulty of barter lead by a process of natural selection, to choice of a commodity which serves to facilitate exchanges or perform the functions of money.

Nature

Money is then originally a commodity, possessing in addition to its primary utility, a secondary utility which fits it to facilitate exchanges, and is in consequence selected by the community to perform certain special functions which differentiate it from all other commodities.

Functions

1 Medium of exchange.

A commodity serves as a medium of exchange when for it a producer can exchange anything he has to sell, and with it purchase anything he desires to buy.

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2 Measure of value, or common denominator of value.
The value of two commodities in relation to each other can be determined by expressing the value of each in terms of a third commodity of stable value, which then becomes a common denominator or measure of their value.

3 Standard of value.
When commodities are sold with an agreement for deferred payment, a commodity of stable value is required, in which such payment shall be made to secure the creditor against loss. Such commodity serves as a standard of value.

References

Jevons. Money and the mechanism of exchange, ch. 1–6.
McAdam. An alphabet in finance, ch. 1–4.
Walker, F. A. Money, trade and industry, ch. 1–3.
Brough. Natural law of money, ch. 1.

Walker, F. A. Money, ch. 1–3.
Mill. Principles of political economy, p. 286–92.

Topics for papers

1 State and illustrate the functions of money.

2 To what extent and for what reasons have commodities other than the precious metals been used as money?
Jevons. Money and the mechanism of exchange, ch. 4.

3 Which function of money is most important, and why?

Lecture 2

VALUE OF MONEY AND ITS INTERNATIONAL DISTRIBUTION

Value of money

1 Definitions.
By value of money is meant purchasing power, or proportion in which it exchanges for other commodities.

By volume is meant the total quantity of the commodity employed as money, which is actually available at a given time to facilitate exchanges.

2 Law of value.
The value of money, like that of other commodities, is subject to the law of supply and demand, which in its relation to money may be thus stated. Value or purchasing power of money is directly proportional to demand, i. e. to the totality of commodities offered in exchange; and inversely proportional to the supply or volume.

3 Change of value.
a Significance.
There is no fixed value, hence the value of money, like all other values, is subject to change. This fact is of vital significance in monetary science, and lies at the root of most monetary fallacies and illusions.

b Cause.
The value of money, like all other values, changes by virtue of variations in its supply and demand. Changes in the supply of money may be
General, changing monetary values throughout the world.
Local and temporary, affecting the value of money in a single community.

c Result.
A change in the value of the circulating medium causes a general rise or fall of prices.

d Measure.
Change in the value of money may be measured by comparing the average price at different periods of a selected group of staple commodities. Such a measure can never be more than approximately correct, since prices are affected by other causes as well as by changes in the demand and supply of money.

c Change of the precious metals in relation to each other.

Each of the precious metals is subject to changes of value in relation to the other, because the supply and demand in the case of each is independent of the other, and fluctuating. The ratio of value between them must therefore be fluctuating.

International distribution of money

1 Origin of international trade.

Diversity in conditions of production gives rise to international division of labor, which in turn is the basis of international trade.

2 International trade essentially barter.

The offset of commodities against commodities, is effected by the use of bills of exchange, and an international clearing system, the balances settled in metallic money being relatively small.

3 Significance of international balances.

International balances indicate, in their simplest form, a disturbance of monetary equilibrium, that the value or purchasing power of metallic money in countries affected is above or below the general level of values in the commercial world. Money tends, like other commodities, to seek the best market, i. e. to go where its purchasing power is greatest, or in other words, where prices are lowest. Low prices, as stated above, indicate a relatively small volume of money. Hence the current of money is from large volume and high prices, to small volume and low prices, tending constantly to bring the disturbed prices to the general level, and equitably distribute the world's stock of metallic money.

4 Gresham's law.

a Statement. Only coin of standard weight and fineness will serve for international payments. Worn and clipped coins will not be exported because they circulate at home at their nominal value, while they would be taken in international payments only at their intrinsic or commodity value. Thus coins of standard weight and fineness may disappear from circulation, and be hoarded or exported as fast as they come from the mint. It was chiefly the observation of this fact which led Sir Thomas Gresham to announce the law that bad money will drive good money out of circulation when they are of equal debt-paying power.

b Scope. The principle applies to any form of depreciated currency, and has been repeatedly illustrated in the history of paper money issues, and attempts to secure a bimetallic circulation. It is the principle applied in "token" coinage.

c Modification. The law is not true in its unqualified form. The expulsive power of a depreciated currency is in proportion to its volume, and the full value currency may remain in circulation as long as the depreciated currency is inadequate to effect the exchanges.

References

Jevons. Money and the mechanism of exchange, p. 80–85.
Walker, F. A. Money, trade and industry, p. 38–55.
McAdam. An alphabet in finance, ch. 7

Walker, F. A. Money, ch. 3.
Mill. Principles of political economy, bk. 3, ch. 5, 17

Topics for papers

1 Explain and illustrate the process of international distribution of money.

2 Describe the operation of Gresham's law in the history of United States coinage.

Laughlin. History of bimetallism in U. S.; see index *Gresham*.

3 Is any form of value changeless? Give the reason for your answer.

Lecture 3

CREDIT MONEY

GOVERNMENT NOTES AND "FIAT" MONEY

Definition of credit money

Under the term credit money may be conveniently grouped certain non-metallic media of exchange, including gold and silver notes, government notes, bank notes and bank credit.

Common characteristics

1 Such media have no intrinsic or commodity value. They can not, therefore, measure value. Value can only be measured by the commodity money which they represent.

2 Their value depends not only on the quantity in circulation, but also on the certainty of redemption.

3 They have the great advantage of convenience in handling and transportation, and preventing loss and waste from wear of coin.

Differences

The common characteristics above described are superficial.

The principal forms of credit money differ radically in their origin, nature and economic function, and the key to many financial problems will be found in a clear comprehension of these differences.

Gold notes

These are notes issued against a deposit of gold coin, unit for unit, the coin being held to redeem the notes. The U. S. gold certificates are an excellent example. Such notes conform in all respects to the laws of metallic money, but they do not economize coin nor save interest.

The U. S. silver notes or certificates are unique forms of credit money occupying an intermediate position between the greenback or government note and the gold certificate. Their origin and economic significance will be discussed hereafter.

Government notes

1 Origin.

Issues of government notes have usually originated either (*a*) in the financial exigencies of government (particularly in time of war) or (*b*) in a popular demand based on the alleged scarcity of money (particularly in new countries).

2 Circulation.

The prompt redemption of such notes in metallic money is rendered impossible by the very causes which lead to their issue, and accordingly various legislative devices are employed to encourage or to force their circulation. The principal devices are legal-tender laws and laws making them receivable or even requiring their use, in payment of public dues.

3 Value.

The value of such notes depends primarily on the quantity issued, precisely as the value of metallic money depends on its quantity. Under certain conditions the value is affected by the prospect of redemption, but given a stable government and an active circulation, the value of irredeemable notes will vary inversely as the quantity.

4 Defects.

a Redundant.

Government notes are almost invariably forced into a circulation already full. This makes them at once redundant in quantity and causes depreciation.

b Inelastic.

They are absolutely devoid of elasticity. The excess can not go abroad as in the case of metallic money, and it can not be retired by the regular course of business as in the case of bank notes.

c Unsettle other values.

By their depreciation and fluctuation in value they unsettle all other values. As redundant, they foster reckless speculation; as fluctuating, they convert even the transactions of legitimate trade and commerce into speculative ventures.

d Expensive.

To the government, if it keeps faith, because it must make its purchases in depreciated notes, and redeem the same notes at their nominal value.

To all creditors and persons with fixed incomes by reason of depreciation.

To the holder of the notes in case of repudiation.

e Delusive.

By no means least of the evils of government issues are the financial fallacies and delusions to which they give rise, and the hostile interests which they evoke, making the pathway back to sound money a hard and thorny one.

5 Regulation.

The evils of government issues may be reduced to a minimum by keeping the notes at par with standard metallic money. A stable and solvent government can accomplish this by not allowing the quantity to exceed that which would be assigned the given country by the natural law of distribution. (*Lecture 2*)

"Fiat" money

1 Meaning of the term.

The circulation of irredeemable notes apparently confirms the theory of a circulating medium, possessing neither commodity nor credit value, yet invested with all the functions of metallic money purely by governmental authority, by the "fiat" of a legislature.

2 Ground of the theory.

The theory is grounded on the observation that money, as a mere medium of exchange, serves simply to express the ratios according to which commodities are exchanged. The primary utilities of metallic money, the qualities which make it valuable, are not essential to it as a medium of exchange.

3 Confirmation.

Other phenomena of money seem to confirm this conception, e. g. seigniorage in excess of cost of coinage, subsidiary and token coinage.

4 Deductions.

Such phenomena are held to prove:

a That value is not essential to money.

b That commodity and credit money may accordingly be entirely dispensed with. Stamped bits of paper converted into money by government "fiat" will circulate and perform all money functions.

c That such money, being independent of any specific commodity value, would not fluctuate in value.

5 Criticism.

There is a radical defect in the theory which renders all its observations and deductions worthless. It overlooks (*a*) that the basal function of money is to measure value; (*b*) that nothing can measure value which does not possess it; (*c*) that legislative

fiat can not create value. It follows (*a*) that the base of any and every monetary system must be commodity money; (*b*) that other forms of money in the system perform their functions only because they are expressed in terms of commodity money and are founded on it through the instrumentality of credit.

References

McAdam. An alphabet in finance, ch. 15–19.
Trenholm. The people's money, ch. 13–14.
Walker, F. A. Money, trade and industry, ch. 8–9.
Jevons. Money and the mechanism of exchange, p. 234–36.
Upton. Money in politics, ch. 4, 12–14.
Wells. Practical economics, p. 58–63 (Fiat money).

Mill. Principles of political economy, p. 344–63.
Sumner. History of American currency, p. 197–227.
Walker, F. A. Money, ch. 14–17.
Knox. United States notes.
Hill. Absolute money (Scheme of "fiat" money), p. 45–113.

Topics for papers

1 State and illustrate the defects of government notes as money.

2 Give a brief account of the "Greenback" issues in the U. S.

Upton. Money in politics, ch. 12–14.

3 Do you favor retaining in our circulation the existing greenbacks? Give the reason for your answer.

Lecture 4

CREDIT MONEY— *Continued*

BANK NOTES

Origin

In the early stages of industry, exchanges are chiefly local and consist largely in simple trade. The growth of domestic commerce not only makes additional demands on the medium of exchange, which metallic money can not supply, but from its very nature requires an instrument of far greater cheapness, convenience and elasticity. The bank note originated in the effort of the commercial world to supply itself with such a medium.

Nature

Under normal conditions a bank note is a written promise to pay the holder on demand a specified sum of standard metallic money. The guarantee of the issuing corporation makes it acceptable as a medium of exchange, and it becomes a positive addition to the circulating medium resting, in the last analysis, not on the coin reserve held to secure its redemption, nor even on the credit of the issuing corporation, but on the promissory note of an individual, in exchange for which it was originally issued, which note in turn, when legitimately given, is guaranteed by goods or commodities in process of production or distribution.

Function

The normal function of the bank note is to make immediately available the purchasing power of commodities in process of production or distribution, so that raw material, labor or finished products may be purchased before returns from previous sales can be secured.

Advantages

1 Economy.

It supplies an efficient medium of exchange without the enormous expense of mining.

2 Elasticity.

Its amount can vary to any extent in quick response to the demands of commerce.

3 Convenience.

It can be handled and transported far more easily, quickly, cheaply and safely than metallic money.

Regulation

The principles which should be applied in the legislative regulation of bank-note issues may be deduced from the nature and function of such notes. The principal objects to be secured by regulative measures are safety and elasticity.

1 Safety.

Safety depends ultimately on the character of the individual notes for which the bank notes are issued. These should be short term business paper. Other safeguards employed are: prescribed reserve of standard money, maximum limit of issue, joint safety fund, and bond security.

2 Elasticity.

Elasticity depends on the prompt return of the notes to the issuer in payment of the individual notes in exchange for which they were issued. To secure this result they should be issued only in large denominations. If issued in small denominations, they pass into the channels of retail trade, remain permanently in circulation and inflate the currency.

References

McAdam. An alphabet in finance, ch. 10–13.
Trenholm. The people's money, ch. 15.
Brough. Natural law of money, ch. 3.
Dunbar. Theory and history of banking, ch. 2, 5.
Jevons. Money and the mechanism of exchange, ch. 18–19.

Colwell. Ways and means of payment, ch. 9.
Poor. Money and its laws, p. 10–61.
Price. Principles of currency, lectures 3–4.
Mill. Principles of political economy, p. 325–31.

Topics for papers

1 Explain the origin and economic function of the bank note.

2 Give a brief account of the national bank system in the U. S.

Lalor. Cyclopædia, *art.* Banking (Knox), v. 1, p. 215–12.
Upton. Money in politics, ch. 15.
Dunbar. Chapters on the theory and history of banking, ch. 9.

3 Apply the principles of the lecture to the criticism of national bank notes.

Lecture 5

CREDIT MONEY — *Continued*

BANK DEPOSITS AND BANK CREDIT AS MONEY

Mechanism

Banks of deposit and discount provide their customers with a safe and convenient method of making payments without the use of either metallic or paper money. The simplest case is where two individuals are depositors in the same bank. In this case payment involves:

1 An order or check on the bank transferred by debtor to creditor.

2 Deposit of the check by the creditor.

3 Transfer of credit by the bank, the check deposited exactly balancing the check drawn.

Expansion

1 Single bank.

In the case assumed above, a bank could make loans to its customers and so expand its credit indefinitely, provided all payments were made with checks; for such loans would be transformed at once into deposits and then effect payments like other deposits, by the mechanism described above, without the use of metallic or paper money.

2 Group or system of banks.

Similar expansion may take place in a group or system of banks by means of clearance.

a Definition.

Clearance is the offset or cancelation of the mutual obligations of a group of banks. An institution designed to systematize and facilitate such cancelation is called a clearing-house.

b Significance.

The very great practical significance of clearance consists in the fact that it enables all the banks of a related group to expand their credit and increase their deposits through loans precisely as in the simple case assumed above, because it enables the banks to pay checks by transfer of credit on their books. 92 % of checks drawn on the banks of this country are thus paid.

c Gradations.

Clearance is

Local, effecting payments between individuals of the same locality.

National, effecting payments between individuals in different localities in the same country.

International, effecting payments between individuals in different countries.

Economic function

The economic function of bank credit is essentially the same as that of bank notes as described in the preceding lecture, but its extensive use belongs to a higher and more complex development of the industrial system, and it is accordingly a more refined and convenient, as well as a much cheaper and safer method of effecting exchanges, than the bank note. They are distinguished, too, by the different industrial spheres in which their chief work is performed. The bank note is most useful in the purchase from the producer of agricultural products and in other exchanges in rural communities; bank credit, in the purchase at wholesale, of all commodities in process of production or distribution. Bank notes are the money of the farmer and rural dealer; bank credit, of the manufacturer, jobber and city dealer.

Importance of discount banks

Comprehension of the nature and function of bank credit reveals the vital importance of the bank of discount to the industrial system. Its chief function is seen to be the creation of a medium of exchange adapted to the needs of commerce. The raw material of this medium consists of promissory notes of individuals. These are transformed into credit by the banks, and their credit, transferred by checks which are offset in the clearing house, effects the wholesale exchanges of the country; finally, since prices are determined by the wholesale exchanges, it is on this invisible and intangible money rather than on the silver and gold and greenbacks of retail trade, that prices chiefly depend.

Volume

The volume of bank credit at any given time may be approximately ascertained by finding the total of outstanding loans and discounts.

References

McAdam. An alphabet in finance, ch. 24.
Jevons. Money and the mechanism of exchange, ch. 20–22.
Dunbar. Theory and history of banking, ch. 4, 5.
Walker, J. H. Money, trade and banking, ch. 10–14.

Macleod. Elements of banking, ch. 6; p. 267 and following.
Colwell. Ways and means of payment, ch. 10–11.
Mill. Principles of political economy, p. 332–42.

Topics for papers

1 Show how clearance is essential to the expansion of bank credit.

2 Give an account of the New York clearing house.
Gibbons. Banks of New York and the clearing house, ch. 18.

3 Can you justify the banks for charging interest on the loan of their credit?

Lecture 6

INDUSTRIAL ORGANISM

PANICS AND COMMERCIAL DEPRESSIONS:

Growth

1 Economic dependence.

The industrial organism develops step by step with the division of labor as it passes from the simple to the complex stage. At this stage production is centralized and the area of distribution correspondingly enlarged. Hence products in their transition from the original raw material to the ultimate consumer pass through many hands both in process of manufacture and distribution, and establish at every step relations of economic dependence.

2 Credit dependence.

Still further, at each stage in the transition an exchange takes place, and the product must be paid for as often as it changes hands. Metallic money can not be employed to effect these numerous wholesale exchanges not only because it is utterly inadequate in amount, but also because the expense, inconvenience and friction of its use would put an intolerable burden on industry. The problem is solved by the use in the first instance of individual credit, chiefly promissory notes, and this unites the same producing and distributing group by relations of credit dependence.

3 Dependence on banks.

Individual credit, as we have seen, can only initiate, it can not complete the wholesale exchange. Here the function of the other great factor in the industrial organism clearly appears. The discount banks are the digestive system, converting individual credit into the corporate credit by which the exchanges are completed, and thus furnishing the lifeblood of the commercial organism. It is on this vital relation of the two great factors that the possibility of panics depends.

Danger

The dangerous, explosive factor in this system is the fact that the entire volume of bank credit is made convertible into lawful money on demand, while the volume of lawful money is of course utterly inadequate for immediate conversion.

Cause of panics

The integrity of this system obviously depends on the reciprocal confidence of the two great factors. Anything, therefore, which undermines or destroys this confidence may produce a panic. The chief causes are three:

1 Distrust of the individual credit on which bank credit is based, by reason of speculation.

2 Distrust of the paper or other currency in which bank obligations may lawfully be paid.

3 Distrust of the metallic foundation of the whole monetary structure, by reason of the export of specie.

Course of panics

1 Premonitory symptoms.

a Contraction of loans by banks, producing stringency or a "tight" money market, and bringing pressure on the whole credit system.

b Failure of the weaker concerns, intensifying distrust.

c Pressure on the trading community reacts on the banks through withdrawal of balances; weak banks suspend and runs begin on strong banks.

d Distrust of the banks causes hoarding of currency, which greatly aggravates the stringency and hastens the crisis.

2 Crisis.

The crisis proper is the period of greatest pressure. By pressure is generally meant, the effort to convert the volume of bank credit into lawful money. More specifically it is (*a*) pressure by the banks on producers and distributors through the refusal to discount, the digestive system refusing to supply blood; (*b*) pressure on the banks by producers and distributors through withdrawal of deposits, the opening of the veins on which the life of the digestive organs depends.

3 Attendant phenomena.

a Excessive rise in the rate of interest.

b Excessive fall in values.

c Paralysis of the industrial organism.

d Excessive liquidation in settlement or cancelation of credit obligations, through sacrifice or failure, thus reducing the volume of credit and relieving the strain.

4 Alleviation of stringency.

The severity of crises may be relieved:

a By devices for temporarily increasing or economizing currency, e. g. clearing house certificates.

b By a bold initiative of sound banks in increasing loans at times of greatest pressure.

c By greater popular intelligence regarding the structure and working of the credit system, preventing runs on sound banks and senseless hoarding of money.

Prevention

It follows from the preceding that the only adequate prevention or remedy for panics is the possibility of immediately and indefinitely increasing the supply of lawful money. No form of circulating medium is so well adapted to meet this requirement as the bank note when its issue is freed from unnecessary limitations; for it enables sound banks to meet both demands, the demand for discount and the demand for withdrawal, and at once banishes the panic fear.

Commercial depression

A panic may cause commercial depression, but the latter may occur without a panic. In such a case it is invariably a natural reaction from a period of inflation and speculation. The movement is salutary up to a certain point, i. e. till the element of speculation and inflation is removed. It is only dangerous when it passes into the acute or panic stage, for here it brings paralysis and ruin on legitimate industry. Such periods of depression can not be prevented so long as the industrial movement maintains its present rythmic form with alternating excitement and reaction.

References

Lalor. Cyclopædia, *art.* Commercial crises (White), v. 1, p. 523–30.
Bagehot. Lombard street, ch. 7.
Brough. Natural law of money, ch 8 (Panic of 1893).
Macleod. Elements of banking, ch. 5 and p. 219–35.

Topics for papers

1 Explain why a monetary crisis causes industrial paralysis.

2 Describe the principal features of the panic of 1893. Brough. Natural law of money, ch. 8.

3 Trace the possible connection between a crop failure and a panic.

Lecture 7

INTERNATIONAL MONEY

Relation to national exchanges

The various media of domestic exchange are vitally dependent for their safety and efficiency on international exchanges. Knowledge of the nature of this dependence and of the instruments and mechanism of international payments is essential to the student of money. The contemptuous question: "What have we to do with abroad?" when applied to our monetary system, only displays ignorance.

Mechanism of international payments

1 Commercial bills.

The mechanism of international exchange in its simplest form is based on the fact that normally "imports" of goods are paid for by "exports" of goods and not by money. In each country, therefore, there are importers and exporters or debtors and creditors of the foreigner. The mutual obligations are canceled by written orders for payment, made by the exporters of one country, transferred for their value to the importers, sent to the foreign exporter and paid as ordered by the foreign importer. Such orders are commercial bills of exchange.

2 Bankers bills.

The risk and friction attending payment with commercial or individual bills has led to their absorption to a large extent by the foreign exchange banks, which issue to the importer their own orders or drafts on their foreign branches or representatives. Such orders are called "bankers bills," and the corporations which issue them, by converting individual into corporate credit, perform a function

in international exchanges precisely analogous to that by which the discount bank converts individual notes into bank credit.

3 Fluctuation.

a Point of equilibrium or "par of exchange."

When two countries have the same standard of metallic money, the ratio of pure metal in the legal monetary unit of the one to that in the corresponding unit of the other is called the par of exchange. When bills of exchange have a value corresponding to this ratio, exchange is said to be "at par."

b Limits of fluctuation or "gold points."

The value of bills fluctuates about the par of exchange under the influence of changing supply and demand, but there are, obviously, limits to such fluctuation fixed by the cost of remitting specie. The price of bills can not pass the point where it becomes more profitable to send specie than to purchase a bill of exchange. These points are called "gold points."

Mercantile theory

1 Statement.

The so-called mercantilists held that wealth consists solely in the precious metals; that a nation can therefore only increase in wealth by exporting more goods than it imports so that the "balance" may be received in gold and silver. Hence the origin of the terms "favorable" and "unfavorable" balance of trade.

2 Refutation.

This doctrine may be refuted by showing (*a*) the inadequacy and absurdity of its conception of wealth; (*b*) that international trade, apart from credit transactions, is necessarily an exchange of goods for goods, the flow of specie either way being

abnormal; (*c*) that under normal conditions such exchange is profitable and so "favorable" to both the exchanging countries, and hence under such conditions the value of imports computed from domestic prices always exceeds the value of exports, the difference representing the cost of transportation and the profit of the importer; (*d*) that when movements of specie occur, they, too, are alike "favorable" to both countries because they simply restore the monetary equilibrium which some exceptional influence has disturbed.

Effect of credit transactions on international exchange

The enormous growth of international credit greatly complicates the movement of bullion or specie and renders interpretation difficult. The causes are often complex and seldom admit of precise determination either as to their nature or extent. Thus in addition to the simple "balance of trade" the movement may be influenced by

1 Stock exchange transactions, involving purchase or sale by foreigners of securities, and payment of interest or dividends on the same.

2 Foreign travel, involving transfer of all funds spent by those traveling or temporarily residing abroad.

3 Redundant currency, whether paper money or bank credit, and whatever be the cause of redundancy, will displace specie and lead to export.

4 The varying rates of interest at different centers may cause a specie movement because idle money seeks a high rate of interest.

Relation of specie movement to domestic monetary system

1 Importance of the specie reserve.

All forms of credit money and so the whole structure of credit in a country depends ultimately for its

integrity on the central specie reserve. This is because all forms of credit are expressed in terms of metallic money and theoretically are convertible into metallic money on demand; whether or not they are actually so convertible depends on the suddenness and extent of the demand for conversion, and this in turn on popular confidence in the adequacy and integrity of the reserve.

2 New meaning of "favorable" and "unfavorable" balance.

The importance of the specie reserve to the credit system makes an excessive export of specie "unfavorable" to that system, because by depleting the central reserve it awakens distrust of all forms of credit money.

References

Clare. The A B C of the foreign exchanges.
McAdam. An alphabet in finance, ch. 23, 26.
Cowperthwait. Money, silver and finance, ch. 7–8.
Trenholm. The people's money, ch. 16.

Macleod. Elements of banking, ch. 7.
Goschen. Theory of foreign exchanges.
Colwell. Ways and means of payment, p. 205–28.
Mill. Principles of political economy, bk. 3, ch. 16, 18.
Smith. Wealth of nations, bk. 4, ch. 1 (Mercantile system).

Topics for papers

1 Explain and distinguish the proper and improper use of the terms "favorable" and "unfavorable" balance of trade.

2 How can the Bank of England check an export of specie by raising the rate of discount?

Goschen. Theory of foreign exchanges, ch. 6.
Clare. The A B C of the foreign exchanges, ch. 19.

3 What would be the effect on the exchanges of a sudden increase of foreign travel?

Lecture 8

THE QUANTITY OF MONEY A NATION NEEDS

Importance of the question

The importance to a nation of the quantity of its money supply arises from the fact that quantity determines value or purchasing power, and that the fluctuations in the value of money are demoralizing to industry, and work injustice either to debtors or creditors. The problem of the financier is therefore to determine, so far as possible, what quantity will secure the greatest stability of value.

Absolute quantity indeterminate

An exact, numerical statement of the quantity needed by a given country is impossible, because the factors on which such a statement depends are complex and some of them incapable of exact determination, but the sufficiency or insufficiency of the actual quantity may be inferred with tolerable certainty from attendant phenomena.

Fluctuations of quantity

The determination of the exact amount needed at a given time would be of little value, even if possible, for the monetary need of an industrial nation is constantly changing. It varies with the successive stages of industrial development, the alternations of industrial activity and depression, the growth of population and even with the seasons of the year. The nation needs that quantity which will keep the value of money stable. The value will remain stable if the supply is constantly and exactly adjusted to the varying demand. To meet this requirement the principle of adjustment must be inherent in the system, and automatic in its action. The problem of quantity therefore depends on the problem of elasticity in the circulting medium.

Three chief components

The difficulty of the above problem is increased by the fact that the elasticity of the whole depends on that of the parts, and that there are three principal components in a monetary system, which differ widely in nature and function as shown in the preceding lectures.

1 Gold reserve.

This is the base of a sound monetary system, guaranteeing under normal conditions the convertibility of all forms of credit money, and forming the vital point of contact between the national and international monetary systems. It is inherently elastic, tending to secure by its flow a general level of prices and corresponding stability of value throughout the commercial world. A nation will therefore certainly possess just as much gold as it needs, provided its system of credit money is rightly constituted.

2 Wholesale money.

a Bank money.

Bank money, i. e. bank notes and bank credit, is the natural medium of wholesale trade, and is self-regulating in quantity when issued in accordance with sound principles.

b Government notes.

Government notes, when issued in large denominations, take the place of bank notes. Their great defect is their want of elasticity. Expansion and contraction are alike arbitrary, and may depend on the assumed interests of warring factions rather than on the real demands of commerce.

3 Retail money.

a Definition.

By retail money is meant notes and coins of small denominations in which wages are chiefly paid,

and which are employed in petty payments and purchases by all classes.

b Quantity.

The quantity required depends chiefly on growth of population, use of bank facilities, the general industrial condition of buoyancy or depression, and, these being given, on the efficiency of the constituent coins or notes.

c Regulation.

It may be issued continuously in amounts suggested by experience to meet the demand of growing population and industry, provided (*a*) it be made receivable in any amount for all public dues; (*b*) the issuing agent be authorized to discontinue the issue whenever and so long as it forms an excessive factor in treasury receipts; (*c*) banks be forbidden to count it as part of their lawful reserves.

Conclusions

1 Nothing can be inferred as to the money need of a given country from the per capita circulation of another unless industrial conditions are identical.

2 The most comprehensive rule for regulating the aggregate quantity of money is never to permit it to exceed that which the law of international distribution would assign, for its value would then never fall below the value of international money, and international money is the most stable existing medium of exchange.

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Jevons. Money and the mechanism of exchange, ch. 26.

Colwell. Ways and means of payment, p. 118–22.
Walker, F. A. Money, ch. 3–4.

Topics for papers

1 Explain and illustrate the "efficiency" of retail money, and show its relation to quantity.

2 Compare the Canadian banks of issue with our national banks as regards money supply.

Brough. Natural law of money, ch. 5.

3 Why is England said to be in favor of "dear" money?

Lecture 9

BIMETALLISM AND MONOMETALLISM

Importance of stability in the standard

One of the most important functions of money is to serve as a standard of value, i. e. of deferred payments. Fluctuation in the purchasing power of money or, in other words, changes in the general level of prices, are changes in the standard of value and work all the injustice to various classes described in the previous lecture. Importance of stability in the standard is chiefly proportionate to the development of credit. All forms of credit involve deferred payment, and hence distrust of the standard of value is one of the deadliest foes of the credit system.

Precious metals as standards of value

There is no fixed or absolute standard of value. The value of any commodity chosen as a standard is subject to the law of supply and demand; but the precious metals, though subject to great changes in value, have been found relatively most stable in value and are universally employed as a standard. The standard is said to be fixed when a certain weight and fineness of either metal is made by law the unit of value and standard of deferred payments.

Double standard

A double standard involves the following conditions:

1 Unit of value is defined by law in terms of the weight and fineness of both metals, and hence a legal ratio of value between them is fixed.

2 Coins of either metal are legal tender for all payments.

3 Mints are open on precisely the same terms to both metals.

Practical working of the double standard

Inasmuch as the conditions of supply and demand of the two metals are independent, the actual or market ratio of value between them seldom coincides with the legal ratio. The divergence of these ratios is a condition of the operation of Gresham's law. The cheaper metal, or that which is overvalued in the coinage, tends to drive the dearer out of circulation and become the sole standard of value. The principle applied in subsidiary coinage was deduced from observing this process.

Bimetallism

1 Definition.

Monometallism means one standard based on one metal. Double standard means two standards each based on a different metal. Bimetallism, in its scientific form, means a theory of the possibility, under given legislative conditions, of forming one standard based on both metals.

2 Purpose.

Bimetallism aims to avoid:

a The evils of universal monometallism. The demonetization of the existing stock of silver money, which amounts to one half the metallic money in the world, means great loss to the holders of silver, commercial and financial demoralization in all silver using countries, the crippling of a great mining industry and, worst of all in the opinion of the bimetallist, the throwing of the whole burden of the world's monetary circulation on gold, with a consequent appreciation of its value and fall of prices throughout the world. The recent extensive demonetization of silver is held to have produced, in proportion to its extent, all these effects.

b The evils of the double standard, which spring from divergence between the market and the legal ratio, and practically involve an alternate rather than a double standard.

c The evils of different standards in different countries, which affect exchange relations and constitute a barrier to trade.

3 Theory.

A single permanent, bimetallic standard, it is held, may be established simply by making the system of double standard, as defined above, international or at least inclusive of all the great commercial nations. The chief considerations urged in support of the theory are:

a The double standard, even when confined to a single country, tends to steady the value of both metals through the operation of Gresham's law.

b The universal adoption of the double standard would intensify this tendency so as to lock the precious metals indissolubly together in the ratio of value agreed on; for, assuming a divergence of ratio in any given country, there would be no market in which to sell the dearer metal above the legal ratio, no market in which to buy the cheaper metal below the legal ratio.

c Changes in the supply of or demand for either metal would, under assumed conditions,

affect both in equal degree and the consequent fluctuations of such bimetallic money must be less in extent and less frequent.

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Topics for papers

1 Explain and illustrate the alleged compensatory action of the double standard.

2 Effect of the gold discoveries of 1850.
Walker, F. A. Money, p. 233–42.

3 Does a fall in prices necessarily involve an appreciation of gold?

Lecture 10

SILVER QUESTION IN THE UNITED STATES

Existing system of metallic money

The existing system in the United States is anomalous. The unit of value is defined in both metals and both are legal tender to an unlimited extent; but coinage of silver has ceased. The result is that gold is the actual standard and circulates concurrently with silver, though silver is enormously overestimated in the coinage Again, the recent method of limiting the coinage of silver was unique. It was, as intended, a *via media* between strictly limited coinage and free coinage. The compulsory purchase clauses of both the Bland-Allison and Sherman laws were consequently indeterminate factors, which made it impossible to predict the results of the system on the basis of experience under either strictly limited or free coinage systems.

Why silver has not depreciated

The apparent reason why silver has not depreciated, viz, because it has been redeemable in gold, is superficial. The real reason is that it has not as yet entered into the circulation to excess. The ability of the country hitherto to absorb the silver issues is explained by:

1 Growth of population and development of industry absorbing a large amount of money in small denominations.

2 Contraction of the national bank currency through payment of the bonds on which it was based.

3 Silver was made receivable for customs and internal revenue payments, and a large surplus enabled the U. S. treasury to absorb the excess in periods of depression.

Why silver has not driven out gold

Depreciation of silver and expulsion of gold must occur together, or at least the former event must quickly follow the latter, both being the result of excessive issues. The concurrent circulation of the two metals, with a market ratio widely divergent from the legal, illustrates the modification of Gresham's law noted above. (*Lecture* 2).

Effect of free coinage

Free coinage, it is alleged, would immediately bring the value of silver up to that required by the legal ratio, and thus make every ounce of standard silver worth $1.29. This is nominally true, since the "dollar" or unit of value in the United States, is defined by law in terms of the weight and fineness of both gold and silver, and it might happen, under favorable conditions, that the two "dollars" would circulate at the coinage value for a brief period even under free coinage; but the issue of silver under free coinage would inevitably become excessive, gold would disappear from circulation, silver would depreciate and prices would rise to an extent precisely corresponding to the difference in the intrinsic or commodity values of the gold and silver dollar. Thus with a nominal value of $1.29 a silver dollar would have a purchasing power of, say 75 cents as measured in gold, and our monetary system would have passed from a gold to a silver basis. Among popular monetary fallacies, there is none more subtle than that which assumes that the nominal monetary unit does not change its value, or, as it is popularly expressed, that "a dollar is a dollar."

Future of silver

The recent excessive decline of silver, relatively to gold, is explained by the conjunction of a very great increase of supply with a very great lessening of demand, caused by the closing of European and, more recently, of

Asiatic mints. Whether this depreciation is also partly due to an appreciation of gold is a disputed question. The demonetization movement has been attended by an increased demand for gold; but monometallists hold that the enormous increase in gold production since 1850 has provided a supply adequate to meet this demand without giving gold a scarcity value, and that in fact the movement is but the natural and so inevitable displacement of silver by a medium better adapted to the needs of modern industrial nations. There is little probability of any permanent result from silver agitation either for local free coinage or international agreement. Nature has made silver a retail money unfitted by its bulk for use in international exchanges or bank reserves. As a retail money it will continue to be employed by all nations, and this with its increasing use in the arts will create a permanent demand which will render profitable the working of all but the poorer mines.

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Topics for papers

1 Show why the Bland bill did not cause a commercial crisis.

2 Monometallist explanation of the fall of prices in the last 20 years.

Wells. Recent economic changes, ch. 4–5.

3 Why does the Bank of England pay £3 17s. 10½d. for every ounce of standard gold offered? Why can it not pay a similar fixed price for silver?

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